



**STATE BOARD OF EQUALIZATION  
STAFF LEGISLATIVE BILL ANALYSIS**

DRAFT

Date:	04/17/13	Bill No:	<a href="#">Senate Bill 768</a>
Tax Program:	<b>Cigarette &amp; Tobacco Products</b>	Author:	<b>de León</b>
Sponsor:	American Cancer Association American Heart Association American Lung Association	Sections:	<b>See below</b>
Related Bills:		Effective:	<b>Immediate upon enactment</b>

**BILL SUMMARY**

This measure:

- Imposes an additional excise tax on cigarettes of one hundred mills per cigarette (\$0.10), or \$2.00 per package of 20;
- Indirectly increases the tobacco products tax; and
- Imposes an equivalent compensating cigarette floor stock tax.<sup>1</sup>

**ANALYSIS**

**CURRENT LAW**

Current law imposes an \$0.87 per package<sup>2</sup> (43 ½ mills per cigarette) cigarette excise tax. The components of the cigarette tax and the revenue disposition is as follows:

- \$0.10 per pack (5 mills per cigarette) is allocated to the General Fund (Sections 30101 and 30462 of the Revenue and Taxation Code (RTC));
- \$0.02 per pack (1 mil per cigarette) is allocated to the Breast Cancer Fund (RTC Sections 30101 and 30461.6);
- \$0.25 per pack (12 ½ mills per cigarette) is allocated to the Cigarette and Tobacco Products Surtax Fund (RTC Sections 30122 and 30123); and
- \$0.50 per pack (25 mills per cigarette) is allocated to the California Children and Families (CCF) Trust Fund (RTC Sections 30131.2 and 30131.3).

**Tobacco Products Tax.** RTC Section 30123 imposes a tax on the wholesale cost of the tobacco products distributed at a rate equivalent to the combined cigarette tax rate. In addition, current law imposes an additional tobacco products tax at a rate equivalent to the \$0.50 per pack cigarette tax imposed by Section 30131.2. The Board of Equalization (BOE) determines the tobacco products tax rate annually based on the March 1 wholesale cost of cigarettes. The 2012-13 tobacco products rate is 30.68%.

<sup>1</sup> A floor stock tax is a one-time tax on all tax-paid (stamped) cigarettes and unaffixed tax stamps in the possession of distributors, wholesalers and/or retailers on the effective date of a cigarette and tobacco products tax increase. The floor stock tax rate is the difference between the old tax rate and the new tax rate.

<sup>2</sup> A package of cigarettes contains 20 cigarettes

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Existing law requires the BOE to deposit the tobacco products surtax imposed under Section 30123 into the Cigarette and Tobacco Products Surtax Fund (including any revenues that result from an indirect increase in the tobacco products tax triggered by a cigarette tax increase). Existing law further requires the BOE to deposit the surtax imposed under Section 30131.2 into the CCF Trust Fund.

**Proposition 10 Backfill.** Health and Safety Code (HSC) Section 130105<sup>3</sup> requires the BOE to determine annually the revenue reductions to any Proposition 99 state health-related education and research programs and the Breast Cancer Fund that result directly from Proposition 10's additional taxes. HSC Section 130105 also requires funds transferred from the CCF Trust Fund to affected programs to offset these revenue reductions.

#### PROPOSED LAW

**Cigarette Tax Increase.** This measure enacts **The California Tobacco Act of 2014**<sup>4</sup> (Tobacco Act) to impose an additional cigarette tax at a rate of \$2.00 per package. The Tobacco Act imposes the additional cigarette tax "on or after the first day of the first calendar quarter commencing more than 90 days after the effective date" of the bill.

**Annual Cigarette Tax Rate Adjustment.** This bill requires the BOE to calculate, on or before March 1, an annual adjustment to the additional cigarette tax based on the percentage change to the preceding calendar year's California Consumer Price Index (CCPI) for all items. The adjusted rate applies the next fiscal year. The bill states that in no event shall the tax be less than the rate imposed pursuant to the Tobacco Act of \$2.00 per package of cigarettes.

**Floor Stock Tax.** This measure also imposes a one-time compensating floor stock tax on every dealer (retailer) and wholesaler for each cigarette in his or her possession or control at 12:01 a.m. on the operative date of the additional tax. In addition, this measure imposes upon every licensed distributor a cigarette indicia adjustment tax on affixed and unaffixed cigarette tax stamp inventory at 12:01 a.m. on the operative date of the additional tax. The floor stock tax return and tax would be due to the BOE "on or before the first day of the first calendar quarter commencing more than 180 days after the effective date" of the bill.

**Backfill Provisions.** This measure requires the BOE to determine, within one year of passage and annually thereafter, the effect that the additional cigarette tax and the resulting indirect tobacco products tax increase has on cigarette and tobacco products consumption in this state. If the BOE determines a consumption decrease has resulted directly from the additional cigarette and indirect tobacco products tax, the bill requires the BOE to determine the fiscal effect the consumption decrease has on the California Children and Families Trust Fund (Proposition 10), the Cigarette and Tobacco Products Surtax Fund (Proposition 99), the Breast Cancer Fund, and the General Fund, as described.

The bill requires the BOE to transfer funds from the California Tobacco Tax Act of 2014 Fund (Tobacco Tax Fund) to the CCF Trust Fund, the Hospital Services Account, the Physician Services Account, the Cigarette and Tobacco Products Surtax Fund, the Breast Cancer Fund, and the General Fund, to offset the revenue decrease that directly results from the additional cigarette tax and indirect tobacco products tax.

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<sup>3</sup> Added by Proposition 10.

<sup>4</sup> Article 2.5 (commencing with Section 30130.50) of Chapter 2 of Part 13 of Division 2 of the RTC.

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**Fiscal Provisions.** Except for payments of refunds, this bill requires the BOE to deposit all revenues in the newly created Tobacco Tax Fund, which this measure creates in the State Treasury. The bill establishes the Tobacco Tax Fund as a trust fund. The bill requires Tobacco Tax Fund moneys to be transferred in unspecified percentages to the:

- **Tobacco Prevention and Education Account** for transfer to the State Department of Public Health (DPH), State Department of Education, and the University of California.
- **Tobacco Disease Related Health Care Account** for transfer to the State Department of Health Care Services to improve quality and access to specified health care programs.
- **Tobacco Law Enforcement Account** for transfer to the BOE, Department of Justice, and the DPH for the purpose of “supplementing funding for the enforcement of laws that regulate the distribution and sale of cigarettes and other tobacco products, including, but not limited to, laws that prohibit cigarette smuggling, counterfeiting, selling untaxed tobacco, selling tobacco without a proper license and selling tobacco to minors, and enforcing tobacco-related laws, court judgments, and settlements.”

The bill also states that no more than 2% of the proposed tax may be used to fund any department’s administrative costs.

**Cigarette and Tobacco Products Tax.** This bill amends several sections within the Cigarette and Tobacco Products Tax Law to add conforming and necessary code section references that allow the BOE to properly administer the surtax in a manner consistent with the existing cigarette and tobacco products tax.

**Operative Date.** The bill becomes effective immediately, but the additional excise tax becomes operative on or after the first day of the first calendar quarter commencing more than 90 days on and after the effective date of the bill.

#### BACKGROUND

Proposition 99, approved by voters in November 1988 and effective January 1, 1989, imposed a surtax of \$0.25 per package of cigarettes, and also created an equivalent tax on other tobacco products. Tax proceeds provide funding for health education, disease research, hospital care, fire prevention, and environmental conservation.

Assembly Bill 478 (Ch. 660, 1993) and Assembly Bill 2055 (Ch. 661, 1993), effective January 1, 1994, added an excise tax of \$0.02 per package of cigarettes for breast cancer research and early detection services.

Proposition 10, approved by voters in November 1998 and effective January 1, 1999, imposed an additional surtax of \$0.50 per package of cigarettes. Additionally, the measure imposed an additional excise tax on the distribution of tobacco products equivalent to the additional cigarette tax and imposed an equivalent compensating floor stock tax. The revenues from the additional tax are deposited into the CCF Trust Fund and are used to fund early childhood development programs, and to offset any revenue losses to certain Proposition 99 programs as a result of the additional tax imposed by Proposition 10.

**COMMENTS**

1. **Sponsor and purpose.** This measure is sponsored by the American Cancer Society, American Heart Association, and American Lung Association. The measure intends to decrease smoking rates, improve access to health care, and advance California's tobacco prevention and control programs.
2. **Indirect tobacco products rate increase.** This measure does not directly increase the tobacco products tax; however, existing law triggers an automatic tobacco products tax increase whenever the tax imposed on cigarettes is increased.<sup>5</sup> Specifically, Section 30123(b), as added by Proposition 99, generally requires the BOE to annually determine the tobacco products tax rate at a rate *equivalent to the combined rate of all taxes imposed on cigarettes*.

Additionally, existing law directs the BOE to deposit these indirect tobacco products tax proceeds into the Cigarette and Tobacco Products Surtax Fund (Proposition 99) to fund health education, disease research, hospital care, fire prevention, and environmental conservation.

3. **Indirect tobacco products increase effective date.** Existing law requires the BOE to annually determine the tobacco products tax rate. As discussed in Comment 2, the \$2.00 per pack cigarette tax increase indirectly increases the tobacco products tax rate as a result of Proposition 99.

With respect to the tobacco products rate determination, existing law requires:

- The BOE to annually determine the tobacco products rate;
- The BOE to base the rate on the wholesale cost of tobacco products as of March 1; and
- The determined tobacco products rate to be effective during the state's next fiscal year.

As such, the BOE's rate determination must be no earlier than March 1, but no later than June 30, each year to be effective for the next fiscal year.

Since the last day for the Governor to sign bills is October 13, 2013, the latest the proposed additional cigarette tax could become operative is April 1, 2014. Accordingly, the 2014-15 tobacco products rate determination would include the proposed tax, effective July 1, 2015.

4. **Annual CCPI cigarette tax adjustment.** This bill requires the BOE, on or before each March 1, to calculate the percentage increase in the CCPI for all items of "December of the prior calendar year over the December of the preceding calendar year immediately preceding the prior calendar year." The bill further requires the BOE to apply that percentage increase to the additional cigarette tax of \$2.00 per pack of cigarettes in order to adjust that rate. The adjusted tax would be effective during the state's next fiscal year. The bill prohibits the adjusted tax rate from being less than the proposed additional \$2.00 per pack cigarette tax.

The BOE staff suggests amendments to the adjustment provisions to clarify the following:

- **Initial cigarette increase adjustment calculation date.** The bill requires the BOE to calculate the percentage increase on or before March 1 of each year.

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<sup>5</sup> Imposed under the Cigarette and Tobacco Products Tax Law.

Does the author intend for the date of the BOE's first calculation to be March 1, 2014, or March 1, 2015?

In its current form, it appears the BOE's initial CCPI percentage increase calculation would take place March 1, 2015, and apply to the July 1, 2015, adjusted cigarette tax rate if the bill is signed into law after September 30, 2013. However, if the bill is signed into law before September 30, 2013, the BOE would make the percentage increase calculation on or before March 1, 2014, which would apply to the July 1, 2014, adjusted cigarette tax rate.

- **Cigarette tax rate decrease adjustment.** The bill prohibits any adjusted tax rate from being less than the proposed rate stated in the bill of \$2.00 per cigarette pack. The language also indicates that the base rate to which the rate adjustment applies is permanently set at \$2.00 per cigarette pack, and a calculated percentage decrease never applies. Is this the intent of the author? If this is not the intent, the language should be clear.

Furthermore, BOE staff notes that any resulting adjusted increase to the additional cigarette tax required by this measure would be considered for the *following* fiscal year's tobacco products rate calculation, pursuant to existing law.

5. **Administrative start-up cost funding is essential.** This bill proposes an additional cigarette tax likely to be imposed either January 1, 2014, or April 1, 2014, based on the bill's delayed operative date. As a result, the BOE must begin to implement the bill in fiscal year 2013-14. However, the BOE's 2013-14 budget does not include funding to implement the bill. Consequently, the BOE requires an adequate appropriation to cover administrative implementation costs.

Typically, the BOE seeks administrative cost reimbursement from the account or fund into which tax proceeds are deposited. However, this bill creates the Tobacco Tax Fund, which lacks funding to reimburse the BOE prior to collection of the tax. Upfront BOE implementation cost reimbursement is essential. Thus, BOE staff suggests the bill authorize a loan from the General Fund or other eligible fund to the Fund. The loan would be repaid from taxes collected.

Constitutional and statutory provisions prohibit the BOE from using special fund appropriations to support the administration of the proposed cigarette tax increase. Without an appropriation, it may be necessary for the BOE to divert General Fund (GF) dollars to implement the proposed tax program. A GF diversion typically results in a negative impact on GF-supported programs and related State and local government revenues.

6. **Floor stock tax provisions.** The bill contains language to impose a floor stock tax on the cigarette inventory of every dealer (retailer) and wholesaler, and affixed and unaffixed cigarette tax stamp inventory of a distributor. This one-time floor stock tax applies only to the initial \$2.00 per pack cigarette tax increase, and not to the annual CCPI rate adjustment.

A floor stock tax imposes a one-time tax on all tax-paid (fixed stamp) cigarettes and unaffixed tax stamps in the possession of distributors, wholesalers and/or retailers on the effective date of a cigarette tax increase. The floor stock tax rate is the difference between the old tax rate and the new tax rate. Generally, a measure imposes a floor stock tax to equalize the excise tax paid by cigarette retailers, wholesalers, or distributors on their inventory and those cigarettes purchased after the effective date of a tax increase.

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Having a large cigarette inventory before a tax rate increase takes effect can result in a windfall profit to a cigarette seller. The selling price of cigarettes purchased before the increase, but sold after, can be raised and attributed to the rate increase. These additional funds would represent a windfall profit rather than excise taxes paid to the state. A floor stock tax mitigates this windfall profit. It should be noted that this measure contains a floor stock tax on cigarettes only, and not tobacco products.

While the BOE incurs additional costs to administer the floor stock tax, these costs would be offset by the proceeds from the tax.

7. **Cigarette and tobacco products tax evasion.** Tax evasion reduces state revenues that cigarettes and other tobacco products taxes generate. BOE staff estimates that cigarette tax evasion in California was running at a rate of approximately \$182 million, along with \$94 million in tax on other tobacco products.<sup>6</sup>

During the mid-1990's, the BOE's cigarette tax evasion estimates changed little since there was little change to cigarette prices and excise taxes during that time. However, two major events that occurred since November 1998 dramatically increased California excise taxes as well as cigarette prices (excluding taxes): Proposition 10 and the Tobacco Master Settlement Agreement between states and tobacco manufacturers (tobacco settlement). Together, these two developments, when coupled with typical wholesaler and retailer distribution margins, coincided with an increase in the average prices of cigarettes to California consumers by about 50% in relation to early November 1998 prices. It is estimated that the impacts of Proposition 10 and the tobacco settlement more than doubled the dollar amount of cigarette tax evasion in California.

Since the 1998 experience, the many new measures have been implemented to reduce cigarette and other tobacco products tax evasion. These include the Cigarette and Tobacco Products Licensing Act; an encrypted cigarette tax stamp; and the Prevent All Cigarette Trafficking Act or PACT Act.

This measure increases the cigarette tax substantially, which will result in an increase in the retail cigarette and tobacco products price, to the extent that the tax increase is passed along to consumers. Based on previous experience related to Proposition 10 and the tobacco settlement, along with research of experiences in other states, BOE staff believes the proposed cigarette tax increase and resulting increase in the tobacco products tax could result in both a decrease in actual consumption and an increase in cigarette and other tobacco products tax evasion. The exact magnitude of these responses is uncertain since the proposed excise tax increases are significantly greater than previously experienced.

8. **Increase in state and local sales and use tax revenues.** The total retail sales price of tangible personal property is subject to the sales or use tax, unless specifically exempted or excluded by law. Since the proposed cigarette tax increase and indirect tobacco products tax is not specifically exempted or excluded, it would be included in the total amount of the sales price and, therefore, subject to sales or use tax.

This measure proposes to increase the cigarette excise tax on cigarettes and indirectly increase the tobacco products tax rate. To be reimbursed for the tax, a distributor, wholesaler, or retailer would likely incorporate the additional taxes into

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<sup>6</sup> <http://www.boe.ca.gov/pdf/cig-evasion-07.pdf>

the sales price of the cigarettes and tobacco products sold to other licensees or the consumer. The sales and use tax applies to the retail sales price of product, unless specifically exempt. The Revenue Estimate discusses the impact on state and local sales and use tax revenues.

9. **Distributor discount.** RTC Section 30166 provides that stamps and meter impression settings be sold at their denominated values less 0.85% to licensed distributors. The discount intends to help defray the cost (leasing of equipment/labor cost) to the distributor for affixing the stamps to cigarette packages.

Currently, distributors receive a discount of \$221.85 [(30,000 stamps x \$0.87 tax per package of cigarettes) x 0.85% discount = \$221.85 discount] per roll of 30,000 cigarette tax stamps. By increasing the excise tax on a package of cigarettes to \$2.87, this measure also increases the distributor's discount to \$731.85 [(30,000 stamps x \$2.87 tax per package of cigarettes) x 0.85% discount = \$731.85 discount] per roll of 30,000 stamps.

Since the bill requires an annual CCPI adjustment to the \$2.00 per package cigarette tax, the distributor reimbursement amount will also adjust based on the annually calculated cigarette tax rate.

10. **Cost cap problematic.** This bill limits funding for any department administrative costs to 2% of the Tobacco Tax Fund revenues. However, the bill does not mention reimbursement of the BOE's on-going administrative costs. The BOE staff recommends an amendment to the bill to specify on-going administrative cost reimbursement to the BOE. And while the 2% cap appears to provide adequate funding, the BOE suggests removing the cost cap.

Also, does the 2% cost cap apply to the total of the BOE's costs to administer the additional tax and additional enforcement moneys allocated pursuant to Section 30130.55(c), or only the costs to administer the additional tax?

11. **Proposition 99 backfill.** This measure requires the BOE to determine the effect that the additional cigarette tax, and indirect tobacco products tax, has on the consumption of cigarettes and tobacco products. To the extent that a consumption decrease directly results from the additional cigarette tax and indirect tobacco products tax increase, the bill requires the BOE to determine the fiscal effect the consumption decrease has had on the existing cigarette tax funds: Cigarette and Tobacco Products Surtax Fund, the Breast Cancer Fund, the CCF Trust Fund, and General Fund. The bill directs an amount transferred from the Tobacco Tax Fund to each of the existing cigarette and tobacco products tax funds to offset the revenue decrease resulting from this measure's additional cigarette tax and indirect tobacco products increase.

In addition to the backfill, the bill indirectly increases the tobacco products tax. Existing law requires the BOE to deposit those new revenues into the Proposition 99-enacted Cigarette and Tobacco Products Surtax Fund. The BOE estimates a backfill in the amount of \$9.3 million and \$36 million in 2013-14 and 2014-15, respectively. In addition, BOE staff estimates \$90.4 million in new revenues deposited into the Cigarette and Tobacco Products Surtax Fund.

12. **Enhanced enforcement funding.** The bill requires an unspecified percentage of Tobacco Tax Fund revenues appropriated, in part, to the Tobacco Law Enforcement Account. The bill tasks the Controller to appropriate moneys from this account to the BOE, DOJ, and CDPH for the purposes of:

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Supplementing funding for the enforcement of laws that regulate the distribution and sale of cigarettes and other tobacco products, including, but not limited to, laws that prohibit cigarette smuggling, counterfeiting, selling untaxed tobacco, selling tobacco without a proper license and selling tobacco to minors, and enforcing tobacco-related laws, court judgments, and settlements.

The bill does not specify an allocation percentage to each of the agencies. To make the allocation process straight-forward and to prevent issues with any funding needs from the three agencies that together exceed the account balance, BOE suggests specifying a percentage to allocate to each agency. A percentage-based allocation also helps each agency with staff and resource planning.

## **COST ESTIMATE**

BOE administrative costs related to this bill are substantial. These costs include: taxpayer notification, tax return design, computer programming, cigarette tax stamp design and denomination changes, and compliance and audit efforts to ensure proper reporting, and floor stock tax administration.

Furthermore, the bill requires enhanced efforts to ensure proper floor stock tax reporting and collection, greater compliance efforts for additional billings and delinquencies, and an increase in BOE program and investigative staff presence due to increased tax evasion.

## **REVENUE ESTIMATE**

### **BACKGROUND, METHODOLOGY, AND ASSUMPTIONS**

**Timing of Enactment.** This measure will have partial year revenue impact in fiscal year (FY) 2013-14. Specific FY 2013-14 revenues depend on when this bill is enacted. The bill becomes effective the first calendar quarter more than 90 days after the bill is signed by the Governor and chaptered. October 13, 2013 is the last day the Governor has to sign or veto bills passed by the Legislature. While the Governor may sign the bill on or before September 30, (which would imply a January 1 implementation date) we will assume the last possible signing date. This implies an April 1, 2014 implementation date, which means that revenue impact in FY 2013-14 will be about a quarter of the revenue impact under a complete fiscal year.

**Cigarette Tax.** 951 million tax-paid packs cigarette packs were distributed in FY 2011-12. Since 1980, tax-paid distributions have decreased about 3% per year. We believe that 3% annual declines represent a reasonable estimate of the underlying trend for future years. This trend shows no clear signs of abating. Thus, we believe that tax-paid cigarette distribution likely will decline by about 3% annually for FY 2012-13 and future years absent federal or state law changes.

Based on previous tax increases, academic studies, and research of experience in other states, we believe a tax rate increase as sizeable as proposed in this bill likely would cause both a decrease in actual consumption and an increase in tax evasion. Although the exact magnitude of the split between evasion and consumption is uncertain, we estimate this measure would cause tax-paid distributions to decrease by 17%. This estimate uses a price elasticity of demand of -0.60 calculated by the arc

price elasticity formula, applied to an average estimated November 1, 2013 price of approximately \$5.64 per pack.<sup>7</sup>

This bill would adjust the \$2.00 per pack excise tax rate based on the CCPI. Over the past ten years, the CCPI has increased an average of 2.4% per year. This implies a typical increase in the tax rate of \$0.05 per pack, which would raise the rate from \$2.00 per pack to \$2.05 per pack.

With projected tax-paid distributions estimated to be 724 million packs in 2014-15, a typical consumer price index adjustment implies a gain of about \$36 million in additional cigarette tax revenues, considering likely consumer response. As a result of the CCPI adjustment, revenues would decline less than 1% per year on average rather than 3% per year, the expected long-term decline in tax-paid cigarette distributions.

**Enforcement Funding.** The bill provides funding to support additional law enforcement efforts to reduce cigarette smuggling. However, the current version of the bill does not specify the percentage of revenues that must move to the Tobacco Law Enforcement Account. Nor does the bill specify how much funding the BOE will receive for law enforcement. Regardless of the amounts allocated to additional law enforcement, with administrative and budgetary process timing lags, we do not think this funding will affect law enforcement efforts until at least one year after enactment.

**Floor Stock Tax.** This measure includes a corresponding floor stock tax imposed on inventories on April 1, 2014, our projected implementation date. We assume a three-week supply of cigarettes would be subject to the floor stock tax, based on a combination of expected sales rates before and after the tax takes effect. Since taxpayers have 180 days after April 1 to remit the tax, we assume that all revenue related to floor stock tax is received in FY 2014-15.

**Tobacco Products Tax.** Pursuant to Proposition 99, this measure would result in an additional tobacco products tax equivalent to the new \$2.00 per pack that this bill imposes on cigarettes. The BOE sets the tobacco tax rate prior to the start of each fiscal year using wholesale cost data available as of March 1. In recent years, the BOE has set the rate for the upcoming fiscal year in April or May. FY 2014-15 would be the first year the tobacco tax rate calculations would include this tax rate increase.

The tobacco products tax is based on the wholesale cost of these products at a tax rate equivalent to the tax rate imposed on cigarettes. We determine the rate by dividing the tax rate per cigarette by the average wholesale cost per cigarette. In recent years, wholesale costs of cigarettes have risen, which results in rate declines since the total California excise tax on cigarettes has been constant since 1999. The BOE set the rate for FY 2012-13 at 30.68%. FY 2014-15 would be the first fiscal year affected by this bill. We estimate that, with the additional \$2.00 per pack tax, the tobacco products tax rate in FY 2014-15 would be 67.41%.

The wholesale cost (or wholesale sales) of tobacco products was about \$224 million in FY 2011-12. Tobacco product wholesale cost has increased an average of about 8.7% per year over the past three years. We assume that wholesale costs grow 8.7% per year without this bill's tax increase.

Based on previous tax increases, an increase in the tax rate as sizeable as proposed by this bill is likely to cause both a decrease in actual consumption and an increase in tax

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<sup>7</sup> The general price elasticity of demand formula is:  $e_p = (Q_1 - Q_2) / ((Q_1 + Q_2) / 2) / (P_1 - P_2) / ((P_1 + P_2) / 2)$ , where P = price and Q = sales.

evasion of tobacco products. We estimate sales of tobacco products will decline by a similar percentage as cigarette sales.

This measure adjusts the cigarette tax rate for inflation based on changes in the CCPI. The CCPI adjustments to the cigarette tax rate indirectly increase the Proposition 99 tobacco tax rate. We estimate that a \$0.05 increase in the tax rate per pack equivalent (a typical CCPI adjustment) would imply a \$2.5 million increase in Proposition 99 tobacco tax revenues, taking into account likely consumer response.

**Sales and Use Tax Impact.** We expect that all of the cigarette and tobacco products excise tax increases will be passed on to consumers. For both cigarettes and tobacco products, we added sales tax to the excise tax increase and subtracted from the excise tax increase the sales tax that would decline due to a decline in projected sales to determine net sales tax gains.

#### REVENUE SUMMARY

The revenue impact is shown in the table on the next page. Under our assumption regarding the enactment date, FY 2014-15 will be the first complete year of the measure's impact. For FY 2014-15 the California Tobacco Tax Act of 2014 Fund created by this bill would receive \$1,542.8 million from cigarette sales at the new tax rate. However, the other cigarette excise funds (including the existing General Fund) would lose a combined total of \$125.2 million because fewer packs would be sold. However, this bill's revenues would backfill all of these funds. After backfilling, this measure would generate net revenues of \$1,417.6 million for the California Tobacco Tax Act of 2014 Fund.

The tobacco products tax revenue and sales tax revenue impact are also shown in the bottom part of the table. Proposition 99 tobacco products revenues would increase by \$90.4 million, while Proposition 10 tobacco revenues would decrease by \$4.3 million due to reduced sales of tobacco products, resulting in a net increase of \$86.1 million for all tobacco products revenue. State and local sales and use tax revenue from both cigarettes and tobacco products combined would increase by \$51 million. In FY 2014-15, this bill would generate \$1,554.8 million (\$1,417.6 million + \$86.1 million + \$51 million) in total revenue.

We expect cigarette and related taxable sales revenues to decline in FY 2015-16 and future years for two reasons. First, we assume that floor stock tax revenue (a one-time inventory tax) of \$94.7 million will be paid in FY 2014-15. Second, we assume that tax-paid cigarette distributions would continue to decrease by about 3% per year. Without any other factors affecting revenue, related revenue also would weaken by about 3% per year. However, the inflation adjustment offsets the 3% decline, by approximately 2%, leaving a likely reduction of close to 1% per year. Excluding floor stock revenues and backfills to all funds, cigarette excise tax revenues are projected to be nearly \$1.322.9 billion (\$1542.8 million - \$125.2 million - \$94.7 million) in FY 2015-16.

Revenue Impacts Summary	Fiscal Year (\$ Millions)	
	2013-14	2014-15
Cigarette Excise Tax Revenue Impacts by Fund		
Impacts on Existing Funds:		
General Fund	-\$32.3	-\$125.2
Breast Cancer	-\$3.7	-\$14.4
Proposition 99	-\$0.7	-\$2.9
Proposition 10	-\$9.3	-\$36.0
	-\$18.5	-\$71.9
<b>California Tobacco Tax Act of 2014 Fund (Before Backfilling)</b>	<b>\$373.2</b>	<b>\$1,542.8</b>
<b>Floor Stocks Tax (Included in the Total of Line Above)</b>	<b>\$0.0</b>	<b>\$94.7</b>
<b>California Tobacco Tax Act of 2014 Fund:</b>		
<b>Net Total Cigarette Excise Tax Revenues (After Funds are Backfilled)</b>	<b>\$341.0</b>	<b>\$1,417.6</b>
Net Tobacco Tax Revenue Increase (Propositions 99 and 10; see bottom of table)	\$0.0	\$86.1
Total Net Excise Tax Increase (Cigarettes Plus Tobacco Taxes)	\$341.0	\$1,503.7
State Sales and Use Tax	\$7.3	\$27.0
General Fund (4.19%)	\$6.9	\$25.5
Fiscal Recovery Fund (0.25%)	\$0.4	\$1.5
Local Sales & Use Tax (3.06%)	\$5.0	\$18.6
Transit Tax (at 0.88%)	\$1.4	\$5.4
Total	\$354.7	\$1,554.8
<b>Associated Revenue Impacts on Other Tobacco Tax Revenues</b> <i>(Change from revenues under current law, millions of dollars)</i>		
Proposition 99		\$90.4
Proposition 10		-\$4.3
Total Impact		\$86.1

Analysis prepared by:	Cindy Wilson	916-445-6036	05/06/13
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